January 15, 2005

Committee for Purchase From People Who Are Blind or Severely Disabled
Attn: G. John Heyer
1421 Jefferson Davis Highway
Jefferson Plaza 2, Suite 10800
Arlington, VA 22202-3259

Dear Mr. Heyer,

I am writing in regard to proposed rule making on governance standards for organizations participating in the JWOD program.

The Javits-Wagner-O'Day (JWOD) act is responsible for giving birth to the most successful jobs program ever established for individuals with disabilities. More than doubling in size over the past five years, JWOD contracts provide work for over 40,000 individuals with disabilities. Most importantly, jobs created under JWOD pay prevailing rate wages with fringe; are performed in integrated work environments and are of vital importance to the function of our federal government. Moreover, employment of individuals with disabilities in JWOD contracts saves the American taxpayer tens of millions of dollars each year in federal entitlements such as Social Security and Medicaid. We are proud and privileged to be a part of the JWOD service system.

First, let me applaud your timely intent to address the issue of nonprofit governance for providers in the JWOD system. If true, recent news reports regarding board self-dealing and high compensation levels for upper level administrators of a few JWOD providers open the entire JWOD community to attack. I want to caution, however, that to the best of my knowledge, such extremes in compensation only represent a small fraction of the JWOD community. In fact, the newspaper Oregonian (10/18/05), found that only ten of the largest fifty JWOD producers (which hold 50% of the JWOD contracts) had salaries and fringe exceeding $300,000. Although there may be others, I doubt you will find more than a few of the remaining 550, much smaller, JWOD producers providing administrative compensation exceeding $300,000.

Moreover, you will not find many governing boards that allow large contracts or other business arrangements between the nonprofit agency and members of the board of trustees. While such concerns, perceived or real, must be addressed, a response should be measured and not overly burdensome or punitive for the vast majority of JWOD agencies that are properly governed and pay reasonable compensation.

The Committee’s recent proposals, with a few modifications, would be a significant step forward toward addressing governance concerns.

Most of the Committee’s newly proposed regulations for governance appear to conform to those anticipated from Congress or recommended by the Panel on the Nonprofit Sector (6/21/05). They are simply good practice. I won’t comment on each. We are in agreement with the regulations for which we have not offered a response.

Governance Regulations

(1) The board of directors (the board) should be composed of individuals who are personally committed to the mission of the organization and possess the specific skills needed to accomplish the mission.

(2) Where an employee of the organization is a voting member of the board, the circumstances must insure that the employee will not be in a position to exercise “undue influence.”

> Response: We don’t believe any employee of a nonprofit agency, not even the CEO, should be a voting member of the board. Too many conflicts result. In an agency where the CEO is a voting member of the board then he/she should recuse himself/herself from discussion or vote on any issues concerning the CEO position.

(3) The board should have no fewer than five unrelated directors. Seven or more directors are preferable. The board chairperson should not also be serving as the nonprofit agency’s CEO/President.

> Response: A minimum of seven, preferably ten or more would be our recommendation.

(4) The organization’s bylaws should set forth term limits for the service of board members.

> Response: We recommend that board term limits should not be required. This proposed section raises many issues well known to those of us in the field. We have always argued that the knowledge and loyalty of long tenured Board members is a far more important asset than the value of “new blood”. Both are needed, but at a ratio that is maintained according to the needs of the local nonprofit.
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> It is extremely difficult to recruit good Board members under normal circumstances. It will be an increased burden to replace them in a revolving door environment. From a practical perspective, it would be almost impossible to retain

a financial expert on the board, especially a volunteer, if he/she was replaced every few years. Further, no volunteer, no matter how competent, can effectively understand the operations of a medium or large sized nonprofit after only a short tenure. Lacking a historical base, a Board comprised mainly of neophytes will tend to make rash, uninformed decisions rather than slow course corrections. Further, Board volunteers will have little loyalty if they are scheduled for replacement after only a few years of membership.

At our nonprofit, the average tenure of a board member is 20 years. One of the founders of our company has served over 40 years and continues to serve with distinction. There is no stagnation here nor has there been any scandal or board self dealing. By all measures this long tenured board has been highly successful in pursuing its charitable mission.

Term limits for general board membership will not ensure ethical behavior or business success. We agree that term limits for corporate officers should be established simply as a part of good business practice.

I assume the goal is to replace Board members on a regular basis in an attempt to minimize self-dealing, however, that protection could be accomplished in other ways.

(5) Board membership should reflect the diversity of the communities served by the organization.

Response: Obviously this is a commendable goal, however, if strictly enforced, this recommendation would further limit the pool of available volunteers. Suggest the addition of “To the maximum extent possible” as a buffer.

(6) Board members should serve without compensation for their service as board members. Board members may be reimbursed only for expenses directly related to carrying out their board service.

Response: Absolutely. Further, no board member, nor his or her family, should be involved in any contract or other business arrangement with the nonprofit he/she governs. Contracts given to Board members, even with open bidding, will create in the subject Board member a strong, and possibly unjustified, loyalty to the CEO. When becoming a vendor, the Board member moves from a voluntary advisory position, independent of the CEO, to a vendor with allegiance, not to the agency, but to the CEO who oversees the contract and signs his/her check. Further, even if the board member recuses himself/herself from voting on matters concerning his/her conflict, the remainder of the board, because of their continuing association with the board member in conflict, will be influenced to approve any matter that will benefit their associate. This leads to a *quid pro quo* network that prevents impartial decision making.

Here in NJ, Governor Codey recently ordered all state college trustees to eliminate business ties with the schools they govern, resign or seek an exemption from his mandate for good cause. His sweeping order came as the result of substantial self-dealing by the board of the University of Medicine and Dentistry of New Jersey. Regulations effecting self-dealing by charitable boards should be no different.

(7) The full board or some designated committee of the board should hire the executive director, set the executive's compensation, and evaluate the director's performance at least annually. In cases where a designated committee performs this responsibility, details should be reported to the full board.

(8) The board should periodically review the appropriateness of the overall compensation structure of the organization.

(9) The full board should approve the findings of the organization's annual audit and "management letter" and approve a plan to implement the recommendations of the management letter.

(10) Nonprofits should have a written conflict of interest policy. The policy should be applicable to board members and staff, who have significant independent decision-making authority regarding the resources of the organization. The policy should identify the types of conduct or transactions that raise conflict of interest concerns, should set forth procedures for disclosure of actual or potential conflicts, and should provide for review of individual transactions by the uninvolved members of the board of directors.

(11) The accuracy of the agency's financial reports should be subject to audit by a Certified Public Accountant. The board of directors should have at least one "financial expert" serving;

(12) Nonprofit agencies should periodically conduct an internal review of the organization's compliance with existing statutory, regulatory and financial reporting requirements and should provide a summary of the results of the review to members of the board of directors.

Response: In this climate of enhanced nonprofit corporate compliance, the scope of this proposal is the foundation for good governance. It is also one of the most costly and, we suspect, most neglected part of all business administration. In short, it requires significant staff and/or professional time to complete such a review, with perceivably little gain towards the nonprofit mission in return. Perhaps the independent annual audit, required of almost all nonprofits, could address many compliance questions if its scope is expanded.

(13) Nonprofit agencies should prepare, and make available annually to the public, information about the organization's mission, program activities, and basic audited (if applicable) financial data. The report should also identify the names of the organization's board of directors and executive management staff.

(14) Executive compensation paid to the Chief Executive Officer (CEO)/President and "highly compensated individuals" must be monitored by the board of directors. The full board should approve all compensation packages for the CEO/President and all highly compensated employees through a "rebuttable presumption" process to determine reasonableness.

Governance Practices

(1) Are these criteria comprehensive and inclusive enough to effectively evaluate that a nonprofit agency demonstrates good governance practices and should be deemed qualified to participate in the JWOD Program?

Response: Yes, for current purposes your proposed regulations are sufficient.

(2) Are there additional criteria that should be used, or substituted for the above, to evaluate evidence of good governance practices by nonprofit agencies in the Program?

(3) Should accreditation by one or more state or national organizations be recognized as evidence of a nonprofit agency adhering to good governance practices without further review by the Committee?

Response: Yes-assuming the accrediting body is nationally recognized and incorporates the Committee's requirements into its agency review. CARF has already made overtures in this direction, soliciting comments on new governance standards remarkably similar to Committee proposals. CARF, or any other national accrediting body, could serve as fact finder for the enforcement arm of the Committee. If implemented, a JWOD provider that has been awarded accreditation, inclusive of revised "Governance" standards, would be found compliant. In this scenario the Committee already has a large part of the enforcement function in place for approximately half of its providers, which are CARF certified, and an unknown number of the remainder, which are accredited by another national organization. Moreover, since the nonprofit pays the accreditation fee, the Committee's cost of enforcement is minimized. The Committee, or a designated third party, would still need to review the highly compensated individual salaries and how they may affect JWOD contract costs.

If the Committee does not use an existing third party to ensure compliance with new regulations then how will it be done and at what new cost? Will the historic audits for compliance with JWOD regulations be expanded in both scope and frequency? If done by the Committee, instead of a third party, will it be perceived by the public to be oversight at sufficient arms length?

(4) Should different benchmarks be used for nonprofit agencies that are state, county, or local government agencies, or should they be exempt from any Committee regulations in this area?

Response: Third party accreditation standards have already been established for government entities. Accreditation should be required for participation in the JWOD program.

(5) Should the size and/or the annual revenue of the nonprofit agency be a factor or factors in assessing appropriate governance practices?

Response: They should be subject to standards regardless of size. It is recommended that a subcommittee of the Committee meet with the four or five accrediting organizations with national scope to determine an acceptable methodology by which small agencies can be evaluated at reasonable cost. Perhaps NISH could assist small agencies with a no interest loan. This subcommittee, in discussion with the accrediting organizations, should also be responsible for establishing the overall content of the third party review.

(6) What is the best way to ensure that only qualified central nonprofit agencies and nonprofit agencies, with an internal structure that minimizes opportunities for impropriety, participate in the JWOD Program?

Response: The best way is to require certification from an appropriate accrediting body, inclusive of an acceptable "Governance" standard.

(7) What if any enforcement mechanisms should be adopted to ensure only the qualified central nonprofit agencies and nonprofit agencies participate in the JWOD Program?

Response: See above. If a JWOD provider is unable to meet the requirements of the Committee, after reasonable and substantial attempts at rehabilitation, then the agency should be barred from future JWOD contracts and forfeit existing ones upon renewal.

(8) What steps will the nonprofit agencies and central nonprofit agencies need to take to avoid conflicts of interest among its board members?

Response: 1) Approve a strong conflict of interest policy; 2) prohibit contracts, or other business relationships, between the agency and board members, including the CEO, and/or their relatives; 3) disallow paid staff, including the CEO, from serving as a voting member of the board; 4) disallow any relatives of the CEO to serve on the board; 5) disallow board membership for anyone engaged in a business relationship with the CEO or his/her family.

These steps would not resolve the problem of “friends” of the CEO serving on the board, but it’s a good start.

We suggest you disregard the proposal previously introduced whereby board minutes would be made public. A board acting in its own self interest, instead of the interests of the nonprofit it governs, would simply pursue its self-dealing off-the-record. Such rogue boards have little fear of doing so, since nonprofit boards are not subject to the same strict penalties as are voluntary entities governing public funds.

(9) What steps will the nonprofit agencies and central nonprofit agencies have to take to demonstrate financial responsibility?

Response: Accreditation standards usually contain a section on financial management. If so, then accreditation will satisfy this question.

As can be seen in this section, we feel new governance regulations can be best administered by a third-party accrediting body. They have the structure already in place; they are expert at what they do; they are already accrediting more than half the JWOD providers; they are paid by the agency being reviewed; they are more likely to uncover problems since, in most cases, the scope of the accreditation survey would be much more extensive then just for governance; and, they provide arms length protection against criticism that the fox is guarding the henhouse if in-house reviews were simply expanded.

Effect of Executive Compensation on Fair Market Price Determinations

(1) What is the threshold beyond which the compensation paid to the executives in a JWOD participating nonprofit agency should be considered as influencing a proposed fair market price determination? For example, if the agency receives more than a certain percentage of its total revenue from sales through the JWOD Program, is there a compensation level (total dollars paid or total dollars paid as a percentage of total revenue) at and above which fair market price impact would be deemed to occur?

(2) Conversely, is there a point below which executive compensation, regardless of the dollar amount paid, would not be considered as influencing a recommended fair market price? Is such a de minimis test appropriate for large diversified nonprofits where total JWOD sales represent only a small percentage of total revenue?

(3) Without regard to any analysis of JWOD-related revenue, is there an established benchmark or absolute dollar threshold above which compensation would be deemed as influencing a proposed fair market price?

Response: Questions #1, #2, and #3 are all interrelated. For agencies that bid higher than fair market price where excessive compensation is a factor, then the Committee or a designee should 1) calculate the amount of excessive compensation; 2) apply the amount of excessive compensation across all programs within the agency deriving an allocable portion for JWOD contracts; 3) distribute the JWOD portion across all individual JWOD contracts; 4) reduce each contract price by the allocable portion of the CEO's excess compensation.

(4) Should receipt of documentation to support a "rebuttable presumption of reasonableness" serve to demonstrate that executive compensation does not by itself influence a proposed fair market price or any adjustment thereto?

Response: The process by which a rebuttable presumption is created is quite clear. The validity of the process is, however, directly related to the pool of salaries from which the wage comparison is drawn. Assuming all documentation is appropriate, including the salary pool, then the answer is yes.

(5) To what extent should there be a relationship between the pay and compensation of line workers and highly compensated individuals?

Response: None. While this type of compressed corporate compensation (maintaining salaries around a narrow range) apparently works well for one famous ice cream maker, it should not apply to the real world. Why? First, the anticipated consequence of this proposal would penalize the agencies serving the most severely disabled individuals with the lowest productivity and pay. Second, it suggests the nonprofit sector should adopt the pay compression system of compensation historically adopted by the federal government (and Ben & Jerry's).

The federal government is slowly moving away from this "wage compression" approach to compensation. Historically, federal pay for the government equivalent of "line staff", has been higher than in the private sector, but lower for similar executive positions, thus compressing high and low wages into a more narrow band than found privately (Bureau of Labor Statistics). To address this situation, the Federal Employees Pay Comparability Act (FEPCA) was passed (1990) to increase pay for white-collar federal staff to compare with nonfederal salaries weighted by location. Although white-collar wage comparability with the nonfederal sector has not been achieved, it remains a statutory goal of federal pay policy.

More recently (2002), it was determined by the Congressional Budget Office that wages within the SES system were even more compressed when compared to the nonprofit sector. Low tier SES salary scales are as much as 40% higher than equivalent positions in the private nonprofit sector, while upper level salaries are lower than in the nonprofit sector as they are artificially capped by salaries in the Executive Schedule. To partially address these concerns, Congress introduced legislation that would change the SES pay system. That legislation was passed and implemented in 2004.

If Congress has already determined it necessary to distance itself from a system of closely related salary scales it should not now be revived in the nonprofit sector.

It should be noted, that through the JWOD program itself, wages for disabled participants, mostly “line workers”, have reached levels never before achieved.

(6) At what point would be appropriate to begin a review of an executive compensation package even if the proposed price for a product or service would fall within a range that it could be considered as a fair market price?

Response: Probably at no point. The Committee clearly has the right and obligation to regulate the fair market price of JWOD contracts. Here we are asked if the Committee should extend this well defined regulatory authority to the broader issue of executive compensation-one which will be separately addressed by Congress.

If the Committee doesn’t take action against agencies that pay salaries perceived excessive, the JWOD program will continue to receive negative media and political attention. Action based solely on fair market pricing, however, may prove problematic.

According to news reports, it is primarily at the largest JWOD producers where salaries are an issue. Due to their size, large producers enjoy the economy of scale when bidding. As volume increases, overhead cost as a percentage decreases. Therefore, it can be inferred that volume will allow fair market pricing in large agencies even when allegedly excessive compensation is paid.

If the Committee is basing its authority to penalize agencies paying excessive compensation on its ability to establish fair market pricing, certainly a logical approach, then on what argument will the Committee rely to penalize agencies that bid at fair market prices?

If the overhead burden is cost based, the Committee can easily reduce the contract pricing by an allocable amount of excessive compensation whether or not the price is at fair market. The Committee is, after all, the final arbiter of the fair market price.

(7) What approaches are available to identity and monitor nonprofit agencies executive compensation that would provide such information to the Committee routinely but without placing an undue burden on agencies?

Response: Tax forms.

Executive Compensation

Reaching consensus on what defines excessive compensation will prove elusive. This is probably the reason we are not being asked to comment on this determination. My comments are offered here anyway, in an attempt to be assistive.

In 2004, it was suggested that a CEO receiving more than $207,000 in total wages and fringe benefits would be excessively compensated. Apparently that figure was derived from one of the levels on the 2004 SES schedule. After reviewing the 2005 Federal Personnel Guide it appears the $207,000 calculated did not include incentive awards that can elevate the aggregate salary of an SES member in an agency with a certified executive performance appraisal system to $208,100- excluding fringe. (Although this may be true in fact, in practice the incentive awards add approximately 5% to the average wage.) Nor does the calculation seem to capture the cost of unfunded federal civilian pension liabilities. In 1996 it was reported that the Office for Personnel Management estimated a 40 year amortization of unfunded federal civilian pension liabilities would add another 20 percent to federal compensation costs relative to wages and salaries. I don't know if Congress has addressed this matter over the past 10 years but it is highly doubtful. If anything, the deficiency probably has grown.

As you can see, the real compensation cost of a top SES employee has the potential to move substantially above the originally proposed cap of $207,000. And this is before considering a myriad of other potentially unfunded costs like recruitment, relocation and retention bonuses, severance pay or sabbaticals. There are far too many other benefits received by federal employees, such as the value of job security, the security of pension and retirement funds, limited liability, etc. to make a bright line comparison between jobs in the public and private sector. Please don't misunderstand. We are not implying that public sector workers are overpaid; only that they are paid differently. Even expert comparative wage studies show differing results, depending on the source funding the report.

The suggestion to cap nonprofit salaries at some government level position is not new. In 1995, shortly after the United Way/Aramony scandal, a bill was introduced to cap salaries of nonprofit officers and directors at the level of US Cabinet members. The bill failed. It was not a good idea then and is not an advisable policy now.

It is understandable that JWOD vendors should be held to a higher standard of accountability than our non-JWOD peers in the nonprofit sector. Our contracts are set-asides. Pricing is established by the Committee at rates that, for good reasons, may be slightly higher than those that may be received through competitive bidding. Therefore, although all nonprofit salaries are under scrutiny, it is the JWOD venders that appear to have an unfair ability to increase salaries to excessive levels. This perceived JWOD advantage must be removed when developing the formula to establish the definition of excessive compensation. In order to do so, we need to compare JWOD CEO salaries with those in the greater universe of all appropriate nonprofit salaries.

Fortunately, there are several salary surveys that can provide guidance. One of the most respected salary surveys, used by OMB, is annually produced by Steven Langer. The two major factors in determining pay are location and program size. Langer breaks out both in his analysis. For example, in his 2005 New York/New Jersey edition the median salary for a CEO in an agency larger than 25 million is $216,000, excluding fringe; 10-24.9 million, $175,000; 5-9.9 million, $136,447; 2.5-4.9 million, $107,697; 1-2.49 million, $108,000. Regionalized reports are available.

Other surveys support similar findings but are not categorized by location, only size. Charity Navigator, claiming to be the "largest charity evaluator" pegs median CEO salaries at agencies with budgets over 13.5 million at $251,846 (2005). This figure does not include benefit plans or deferred compensation. The Non Profit Times, claiming to be the "leading business publication for nonprofit management", places CEO median salary at $195,886 (2005) excluding all fringe. The Chronicle of Philanthropy puts the median pay at $316,619 (2004) for nonprofits over 25 million. Workforce.com says $225,700 is the median wage. PRM Consulting, INC. reports a median base salary of $246,800 for executives of nonprofits with budgets in the $16-29.9 million dollar range (2004). All these salaries should be increased by approximately 3.5% for the 2006 calendar year as the data will soon be one year old-7% for the surveys completed in 2004.

If we add 25-35% fringe to these representative survey figures we have a good estimate of total average compensation for a nonprofit CEO of a 25 million dollar or larger company in the New York/ New Jersey area. The number is $290,628. This represents $216,000 (the Langer report) multiplied by the COLA of 3.5% multiplied by a fringe factor of 30%. This fringe estimate is, admittedly, a soft number derived from various reports. At this time it is difficult to determine actual fringe benefit costs due to the definition of what should be included in fringe and the under reporting of some benefits such as deferred compensation, insurance, severance agreements and/or personal use of the nonprofit's property. The IRS has addressed some of this under reporting and future estimates of the actual cash value of benefit packages should be improved.

This estimate of total compensation would have to be adjusted upward or downward depending on size within the over 25 million category, specific location (cities being the highest paid), complexity of the agency, overall commercial nature of the agency's business, tenure and qualifications of the CEO, and a host of other variables. It is presented here as neither a suggested salary cap nor a floor, only as an abstract number to encourage discussion. Similar data is already available for budgets under 25 million. I have spoken to Dr. Langer who has informed me that regionalized compensation studies can be developed for agencies with budgets exceeding 50 or 100 million.

I hope these remarks are helpful and wish the Committee continued success in administering this truly remarkable program.

Sincerely,

Joseph S. Bender
Executive Director/CEO

Patrick Rowe,
Deputy Executive Director, Committee for Purchase From People Who Are Blind or Severely Disabled.